We had requested all cost analyses for non-UNE cost case analyses of the cost of line sharing. BellSouth produced nothing in connection with the order to compel.

So the Competitive Carriers of the South -- and this is with regard to Data Request number 8, moved to hold BellSouth in contempt. On February 10, the Friday that the direct testimony was due before the Commission, BellSouth produced responsive documents to Data Request number 8, which was a cost analysis related to line sharing.

The motion to hold BellSouth in contempt alleges that that cost analysis was created after the motion to compel was granted. So the staff limited the -- we had asked for all cost studies. The Commission staff said they only had to produce the most recent cost study. The problem is the most recent cost study at that time is not the cost study that they produced. They created a new one in order to produce it. And if there's any doubt about that, in BellSouth's response filed that February, the following representation is made by BellSouth counsel. "The most recent analysis BellSouth has done is the one approved by upper management late Thursday afternoon." The motion to compel was granted on Tuesday, presented -- they're referencing a cost study presented to their upper management on Thursday two days later. "As counsel for BellSouth explained to Mr. Watkins on Thursday, February 9," again two

days after the motion to compel was made, was signed by the Commission, "once the analysis was finalized, BellSouth would produce it."

So on Thursday, two days after our motion to compel was granted they still haven't finalized the cost analysis they finally gave us on Friday.

Now, the reason we have moved to hold BellSouth in contempt is it's facially contemptuous for us to ask for a cost study, for the Commission to compel it, and for BellSouth rather than to give us the one that they have, make a new one in that interceding period and then give it to us. Which they readily admit, they hadn't finalized on Thursday, the one they gave us on Friday after the motion to compel on Tuesday.

What we would ask -- now, we asked for two things in our motion to compel, we asked that the testimony of Tommy Williams be struck or the Commission put this off in order for us to get a new analysis and then be able to move forward on a line sharing rate case at that point. We're okay with neither one of those happening. What we would appreciate though is that BellSouth be ordered to provide us with the cost analysis they had before the one they produced so that we can take a look. There's electronic bases within the one they did produce to believe that some of the numbers were changed, probably for this case.

What we would ask is that the Commission order BellSouth to produce the cost analysis that they did immediately prior to the one that they gave us. And that it would be allowed into evidence as a late-filed exhibit. We won't put any new testimony on it. We just want it to keep people honest.

CHAIRMAN WISE: Ms. Foshee.

MR. WALSH: Actually, Mr. Chairman, Ms. Foshee had agreed to let me address the Commission really briefly, which was to say that the reason the staff didn't have a recommendation on this at this point, was it was our understanding that the parties were trying to work this out based on correspondence over e-mail. So that's why we didn't have it as one of the preliminary matters, we thought that this was on hold until the parties could work it out among themselves.

CHAIRMAN WISE: Well, apparently they haven't.

MR. WALSH: They apparently did not. I -- I did not hear back that the matter had not been resolved or that it was ready for Commission decision, I thought it was still being held.

MS. FOSHEE: Thank you, Mr. Chairman. And notably we had not heard about that until about five minutes before this hearing started. As Mr. Watkins told you, we produced the documents responsive to request number 8 a week ago

Friday. And we haven't heard anything from Covad about this not being resolved.

As the Commission is aware from our response to the motion to compel, we told the Commission that we were fine with extra time for Covad to file its testimony. We were also fine with a bifurcated hearing on line sharing, but given that we are all here and ready to testify and neither of those seem to be real viable options.

With respect to his factual contentions about what it is that we produced or didn't produce, as you are aware what the Commission decided in the motion to compel was that BellSouth was directed to provide the analyses and supporting documentation for its most recent line sharing analysis. That is exactly what we did. We did not create an analysis to produce in response to this data request. Rather, if you recall, it has been BellSouth's position all along and we've been fairly vocal about this that we didn't think we had a 271 obligation to provide line sharing. Consequently, any negotiations that we have had with Covad about this have been in the context of commercial negotiation and frankly had lots of factors in play, not just line sharing.

When this Commission ordered that we did have a 271 obligation to provide it, that necessitated us determining a just and reasonable rate for stand-alone line

sharing. We went back, our folks got together, one of whom is here today and who is going to testify about this, and put together an offer. That is our most recent line sharing analysis. That is the analysis that we produced to Covad, it's the one that's in Mr. Williams' testimony. So, I think what Covad is trying to do is simply reargue your decision on the motion to compel that it apparently doesn't like. And we would ask you not to do that.

CHAIRMAN WISE: Tell me about the previous study then, what seems to be going on there, Ms. Foshee?

MS. FOSHEE: Let me preface my response to that with a statement that we believe that the commercial negotiations between the parties were conducted in a confidential environment and so to the extent that questions are asked about those today, we will likely object to those. But in response to your question, the last offer that was in play, was an offer by BellSouth at the request of Covad that put line sharing and loops and transport together. So, it was a package deal that made it economically viable potentially for both companies. That offer was declined by Covad. So, that offer was no longer on the table, the one for which he's seeking the underlying documents.

The offer that is now on the table is the one that's attached to Mr. Williams' testimony and it is the offer that is responsive to what this Commission has ordered

us to do, which is provide stand-alone line sharing under 271.

COMMISSIONER BAKER: Let me just ask a point of clarification, at the time the request was made, and this is request number 8, what line sharing analysis did you have at that time?

MS. FOSHEE: That was the analysis that we were undergoing as a result of your order to produce -- to provide line sharing as a stand-alone 271 element. That is the most recent analysis that we have done on this issue.

COMMISSIONER BAKER: No, let me rephrase it again. At the time of the request that was made under number 8 --

MS. FOSHEE: Yes, sir.

COMMISSIONER BAKER: -- what was the existing complete line sharing analysis that you had?

MS. FOSHEE: That's a different question, with all due respect.

COMMISSIONER BAKER: It is a different question.

MS. FOSHEE: But the answer --

COMMISSIONER BAKER: It has to be more precise, because you were being evasive in your response. And I'm being more precise in my question. What was the complete line sharing analysis that existed at that time?

MS. FOSHEE: The last line sharing analysis that the company had done is the line sharing analysis that I

just described to the Chairman, which was a complete package offer that involved those line sharing loops and transport.

COMMISSIONER BAKER: Was that produced in response to request number 8?

MS. FOSHEE: No, sir.

COMMISSIONER BAKER: Okay, subsequent then -- then the line sharing analysis that was produced then was produced subsequent to receiving the request under -- for request number 8, is that correct, yes or no?

MS. FOSHEE: No, sir. It was completed subsequent to receiving the request, but we started it when we received your order directing us to provide line sharing as a 271 element. But there's no question, as I told Mr. Watkins, as we said in our response, you know, these things don't happen overnight. The folks started doing the analysis, they came up with the rate and we presented that rate to upper management for approval to offer it. The timing of that unfortunately necessitated us to produce the information to CompSouth a day after we produced everything else or two days after.

CHAIRMAN WISE: We can expect that Mr. Williams will clearly respond to the questions not subject to trade secret and the like?

MS. FOSHEE: Yes, sir. And as I told you, we will in all likelihood object to those questions, because we do

feel that they're confidential settlement -- or confidential negotiations, but it certainly would be in you purview to overrule those objections.

CHAIRMAN WISE: And I'm going to want to know to what extent that they are subject, you'll need to go into a little more depth at that time.

MS. FOSHEE: Yes, sir.

CHAIRMAN WISE: If it's an attempt to keep this from being part of the testimony today, then it'll be a problem.

MS. FOSHEE: Okay.

CHAIRMAN WISE: And I'm going to deny the Covad motion.

MS. FOSHEE: Thank you.

CHAIRMAN WISE: Mr. Taylor -- Dr. Taylor and Mr. William coming up as a panel today?

MS. FOSHEE: No, sir.

CHAIRMAN WISE: I'm sorry.

MS. FOSHEE: No, they're not.

CHAIRMAN WISE: Okay, thank you.

MR. WATKINS: Mr. Chairman?

CHAIRMAN WISE: Mr. Magness.

MR. MAGNESS: There were a couple other matters. One is -- actually. Then there's just one. And this one has -- also has to do with discovery, Commissioners, and

unfortunately there is no paper in front of you because it involves some discovery that was produced Friday around 6:00 p.m. by BellSouth. This relates to CompSouth's discovery request number 2 concerning information related to the development of the rate under the commercial agreement that BellSouth has offered.

And after the motion to compel was granted by the Commission, BellSouth did produce some in the form of a PowerPoint deck, PowerPoint presentation, was informative, but raised some questions we hope to address with the witness we've subpoenaed.

To BellSouth's credit, on Friday evening they apparently discovered some additional responsive information to that discovery request and sent some additional PowerPoint slides to counsel as responsive information. And the issue that we have, after reviewing this over the weekend, is that there are a number of pages missing from the PowerPoint slides. For example, there's a deck of PowerPoint slides that has a title very clearly responsive to the questions that we asked in discovery. But then it begins on page six and continues on. And let me just note, the first set of slides we got were sequentially numbered and had all the pages and seemed very normal. This one begins on page six and it continues, and then it's missing page eight and continues through nine and ten, is missing

page -- I guess that's all on that one.

CHAIRMAN WISE: Mr. Magness, is there any reason to believe that it's relevant to what you're asking for?

MR. MAGNESS: Yes, sir, there is. The sets of information -- I guess I don't have any reason to believe that the pages that seem to be missing, some of them are five pages in a row, some are two pages. Then you get a page and then you skip two more pages. They would seem to be in the flow of this information, all of which we believe is relevant and certainly responsive to the discovery request. The problem we have is -- and I addressed this with BellSouth right before the hearing, after we had noticed this today. We don't know on what basis those were taken out and what we would suggest is we would like -- we would move to compel that those -- that those pages that were deleted be provided.

Given that we want to move forward with the hearing, we would happy with a resolution where they would provide it to staff for in-camera review to determine whether, in staff's view, they are responsive to the discovery request and the ruling on the motion to compel.

COMMISSIONER BAKER: Did BellSouth provide any specific objection why they didn't provide the missing pages to the PowerPoint?

MR. MAGNESS: We received -- we received the

information in an e-mail Friday about 6:00 p.m. and it was represented that it was additional discovery. I don't believe there was any representation about anything missing or not missing. It was just represented as additional information that had been discovered. So, I -- we don't know -- the objection to producing the ones that have been redacted, they seem to be interlineated within each of these PowerPoint presentations, which every other part of them seem to be fully responsive and relevant, so we're kind of fighting with a ghost and would prefer to have a chance to look at them. But we plan to use this information in examination of the witness that's been subpoenaed, maybe tomorrow when that witness is on, so hopefully maybe that information can be provided to staff for review this evening.

CHAIRMAN WISE: Ms. Foshee?

MS. FOSHEE: Yes, Mr. Chairman, I'll be brief.

We did find the documents on Friday and did everything that we could to get them to CompSouth expeditiously and I don't think that they dispute that. If you go back and look at the request, it obligates us to provide documents that are "used or relied on to determine the rate BellSouth offers in its DS0 commercial agreement." And so, my co-counsel, Ms. Mays and I went through the PowerPoints and we pulled out the documents that were not

responsive. I will tell you there are two pages that are -- we pulled out subject to -- because they were attorney-client privilege. And I should have put that in the cover e-mail, we were just trying to get them to them as fast as we could. So, those are privileged, but the remainder we pulled out because --

CHAIRMAN WISE: What about the continuity -- there was a reason that they were put in that order to begin with and if they -- and if they're deleted from what's provided would -- would that not destroy the continuity of the -- of that presentation, that information?

MS. FOSHEE: In our opinion, no, sir. They were stand-alone slides and we didn't feel that the slides that we removed were responsive to the request.

COMMISSIONER BAKER: How is anybody going to know to challenge you on that point? I mean, unless you have specifically filed an objection and if you did that, I don't have a problem with somebody saying that these pages are not relevant because they're proprietal, because they're not relevant to the subject matter requested in the data request.

But you're acting as the judge in this one, and you've made the determination that it's not relevant, I'm not producing it. You can't do that, I mean --

MS. FOSHEE: I mean, correct me if I'm wrong, but

the way that we usually do it, sir, is exactly that. We don't generally file objections to particular pages. It is incumbent upon us to produce documents that are responsive to the data request. We have made a determination that they weren't responsive. CompSouth has raised an objection, you know, our --

CHAIRMAN WISE: Mr. Magness makes a point about allowing staff to review the --

MS. FOSHEE: That would be fine with us.

CHAIRMAN WISE: Okay, when can you have those provided to the staff?

MS. FOSHEE: Right now.

CHAIRMAN WISE: Fine, I'll make a ruling prior to reconvening tomorrow afternoon then.

MS. FOSHEE: Okay. May we proceed?

CHAIRMAN WISE: I'm sorry. Yes, ma'am.

MS. FOSHEE: We're ready.

CHAIRMAN WISE: You have messed with my quick start plan.

MS. FOSHEE: Not me.

MS. MAYS: Commissioners, Mr. Chairman, BellSouth would call Dr. Bill Taylor to the stand, please.

Whereupon,

WILLIAM E. TAYLOR

appeared as a witness herein, and having been duly sworn,

was examined and testified as follows:

DIRECT EXAMINATION

BY MS. MAYS:

Q Dr. Taylor, please state your name and address for the record.

A My name is William E. Taylor. My address is NERA 200 Clarendon Street, Boston, Massachusetts 02116.

Q By whom are you employed and what capacity, sir?

A I'm a senior vice president at NERA and head of the communications practice.

Q Did you cause to be filed in this case testimony consisting of 29 pages?

A Yes, I did.

Q Do you have any changes to that testimony?

A No.

Q If I were to ask you the questions in that testimony, would your answers be the same today?

A Yes, they would.

MS. MAYS: Mr. Chairman, we would ask that the testimony be entered into the record as though read from the stand.

CHAIRMAN WISE: Subject to cross.

(Whereupon, the prefiled testimony of Mr. Taylor follows:)

ON BEHALF OF BELLSOUTH TELECOMMUNICATIONS, INC.

DIRECT TESTIMONY OF WILLIAM E. TAYLOR, Ph.D.

BEFORE THE GEORGIA PUBLIC SERVICE COMMISSION

DOCKET NO. 19341-U

FEBRUARY 10, 2006

I. INTRODUCTION AND SUMMARY

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND CURRENT POSITION.

A. My name is William E. Taylor. I am Senior Vice President of National Economic Research Associates, Inc. ("NERA"), head of its Communications Practice, and head of its Boston office located at 200 Clarendon Street, Boston, Massachusetts 02116.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL, PROFESSIONAL, AND BUSINESS EXPERIENCE.

A. I have been an economist for over thirty years. I earned a Bachelor of Arts degree from Harvard College in 1968, a Master of Arts degree in Statistics from the University of California at Berkeley in 1970, and a Ph.D. from Berkeley in 1974, specializing in Industrial Organization and Econometrics. For the past twenty-five years, I have taught and published research in the areas of microeconomics, theoretical and applied econometrics, which is the study of statistical methods applied to economic data, and telecommunications policy at academic and research institutions. Specifically, I have taught at the Economics Departments of Cornell University, the Catholic University of Louvain in Belgium, and the Massachusetts Institute of Technology. I have also conducted research at Bell Laboratories and Bell Communications Research, Inc.

I have participated in telecommunications regulatory proceedings before many state public service commissions, including the Georgia Public Service Commission ("Commission"). Before the Commission, I testified in Docket No. 3882-U (on incentive and price cap regulation) on behalf of BellSouth Telecommunications, Inc. and in Docket

No. 6863-U (on the probable economic benefits from BellSouth's entry into interLATA market), on behalf of BellSouth Long Distance, Inc. More recently, I testified before the Commission in Docket No. 10767-U (arbitration with ICG Telecom), Docket No. 10854-U (arbitration with ITC^DeltaCom), Docket No. 7892-U (performance measures) on behalf of BellSouth Telecommunications, and Docket No. 11901-U (Phase II) (MCI's complaint against BellSouth's DSL policy).

In addition, I have filed affidavits before the Federal Communications Commission ("FCC") and the Canadian Radio-television Telecommunications Commission on matters concerning incentive regulation, price cap regulation, productivity, access charges, local competition, interLATA competition, interconnection and pricing for economic efficiency. Recently, I was chosen by the Mexican Federal Telecommunications Commission and Telefonos de Mexico ("Telmex") to arbitrate the renewal of the Telmex price cap plan in Mexico.

I have also testified on market power and antitrust issues in federal court. In recent years, I have studied—and testified on—the competitive effects of mergers among major telecommunications firms and of vertical integration and interconnection of telecommunications networks.

My curriculum vita is attached as Exhibit WET-1.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My testimony addresses what the FCC's "just, reasonable, and not unduly discriminatory" standard means when it is applied to the pricing of network elements that remain subject to the provisions of Section 271 but *no longer* to those of Section 251. I also examine, at some depth, precisely what the "just and reasonable" standard for ratemaking ought to mean in light of Sections 201 and 202 of the 1996 Act and, from an economic perspective, what constitutes a just and reasonable price. I understand BellSouth has specific legal concerns about the Commission's authority to address these issues but refer the Commission to BellSouth's brief on those issues.

Q. PLEASE SUMMARIZE YOUR DIRECT TESTIMONY.

A. My testimony addresses the "just and reasonable" pricing standard from both regulatory ratemaking and economic perspectives, and considers the implications of that standard for the discovery of prices for de-listed network elements in competitive markets in which neither buyers nor suppliers are impaired. My principal conclusions are as follows:

1. The "just and reasonable" pricing standard has a long history. It has, however, always been about pricing *outcomes* rather than about a particular pricing methodology (whether imposed by regulation or otherwise). Over the years, the FCC has adopted different methodologies for setting prices of regulated services, all of which have satisfied the "just and reasonable" standard.

2. A critical component of the correct methodology to determine whether a rate is just and reasonable is the degree to which the market for the service at issue is competitive. In competitive markets, just and reasonable prices emerge from the normal operations of those markets. Buyers and suppliers engage in commercial negotiations, based on the minimum and maximum prices that are acceptable to them and their relative bargaining skills. By definition, both buyers and suppliers are non-impaired in competitive markets, *i.e.*, they have alternative sources to buy from or sell to, and the range of feasible prices within which they negotiate is determined in large part by the options that they have.

3. Presently, de-listed network elements are no longer subject to the specific pricing requirements of Sections 251 and 252 of the 1996 Act. However, they must continue to satisfy the "just and reasonable" standard as long as they remain subject to the requirements of Section 271 of the 1996 Act.

4. In competitive markets for de-listed network elements (including mass-market local switching and high-capacity loops and dedicated transport at certain capacities), *just and reasonable rates are (and should be allowed to be) determined by market forces, rather than by regulatory fiat.* Whether such rates would actually be just and reasonable can be verified by applying criteria spelled out by the FCC (*Triennial Review Order*, ¶664). Specifically, the FCC identified tariffed offerings and commercial agreements as two of the standards to which rates could be compared.

5. Under no circumstances, however, should the "just and reasonable" pricing standard be taken to mean prices set at any measure of cost, including the ILEC's historical or embedded cost or a reversion to the pricing formula (TELRIC) that applied previously when the now de-listed network elements were subject to Sections 251 and 252 of the 1996 Act.

6. *Sound economic practice and the FCC's interpretation of the "just and reasonable" standard in the context of de-listed network elements imply that the Commission ought to adopt the rates in the commercial agreements and applicable tariffs.* The

Commission has already approved over 60 BellSouth commercial agreements under Section 252 and, therefore, has already held that the rates contained in those agreements were just and reasonable. The fact that BellSouth has already signed 184 commercial agreements for either mass-market local switching or a DS0 wholesale platform and has intrastate tariffs for both high-capacity loops and transport signifies that purchasing competitors too have found BellSouth's prices to be just and reasonable.

II. THE "JUST AND REASONABLE" PRICING STANDARD

Q. PLEASE EXPLAIN THE ORIGIN OF THE "JUST AND REASONABLE" STANDARD FOR RATEMAKING IN TELECOMMUNICATIONS.

A. This ratemaking (or pricing) standard was set forth initially in Sections 201 and 202 of the Communications Act of 1934 ("1934 Act") and remains a part of the 1996 Act. The two sections provide, in part:

> All charges, practices, classifications, and regulations for and in connection with such communications service, shall be just and reasonable, and any such charge, practice, classification, or regulation that is unjust or unreasonable is hereby declared to be unlawful... (1934 Act, 1996 Act, §201(b))

> It shall be unlawful for any common carrier to make any unjust or unreasonable discrimination in charges, practices, classifications, regulations, facilities, or services for or in connection with like communication service, directly or indirectly, by any means or device, or to make or give any undue or unreasonable preference or advantage to any particular person, class of persons, or locality, or to subject any particular person, class of persons, or locality to any undue or unreasonable prejudice or disadvantage. (1934 Act, 1996 Act, §202(a))

Q. HOW DOES THE "JUST AND REASONABLE" STANDARD RELATE TO DE-LISTED NETWORK ELEMENTS?

A. The FCC requires that ILECs offer de-listed network elements at just and reasonable rates. It has clearly stated so as follows:

> **Section 271 Issues.** The requirements of section 271(c)(2)(B) establish an independent obligation for BOCs to provide access to loops, switching, transport, and signaling, under checklist items 4-6 and 10, regardless of any unbundling analysis under section 251. Where a checklist item is no longer subject to section 251 unbundling, section 252(d)(1) does not operate as the

pricing standard. Rather, the pricing of such items is governed by the "just and reasonable" standard established under sections 201 and 202.[1]

In other words, the "just and reasonable" pricing standard in telecommunications ratemaking is not tied to one specific pricing formula but, rather, has been interpreted by the FCC to mean different things in different contexts. In the context of a competitive market, such as for mass-market local switching, the FCC has held that just and reasonable rates are determined by market processes through successful commercial negotiations.

Q. HOW CAN THE "JUST AND REASONABLE" PRICING STANDARD ACCOMMODATE MORE THAN ONE PRICING FORMULA OR RULE?

A. In the earliest days of regulated ratemaking for public utilities, the Supreme Court laid down the marker for just and reasonable rates in its landmark decision in *Hope Natural Gas*.[2] In that decision, the Court explained that there can be variation within the just and reasonable standard:

> Under the statutory standard of "just and reasonable" it is the result reached not the method employed that is controlling. It is not the theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end. The fact that the method employed to reach that result may contain infirmities is not then important.[3]

Q. WHAT IS THE SIGNIFICANCE OF THE "JUST AND REASONABLE" PRICING STANDARD BEING ABOUT OUTCOMES OR RESULTS AND NOT ABOUT A PARTICULAR PRICING METHODOLOGY?

A. Beginning with the decision in *Hope Natural Gas*, the "just and reasonable" standard has

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[1] FCC, In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers (CC Docket No. 01-338), Implementation of the Local Competition Provision of the Telecommunications Act of 1996 (CC Docket No. 96-98), and Deployment of Wireline Services Offering Advanced Telecommunications Capability (CC Docket 98-147), Report and Order and Order on Remand and Further Notice of Proposed Rulemaking ("*Triennial Review Order*"), released August 21, 2003, ¶7 (p. 14). See also ¶¶662-663.

[2] *Florida Power Commission v. Hope Natural Gas Company*, 320 U.S. 591, 603 (1944).

[3] *Id.*, p. 602.

represented a goal and an aspiration for the formation of telecommunications prices — whether directly through regulatory means or indirectly by facilitating the normal operations of competitive markets. Because that standard is an end in itself, and not a specific means to that end, it is important that the means employed to bring about just and reasonable prices be attuned to the specific circumstances in which those prices are formed. The object, as always, is to end up with prices close to those that would emerge from a competitive market process. Thus, in 1996, because CLECs were assumed to be impaired without unbundled network elements ("UNEs"), TELRIC-based rates[4] were adopted as an estimate of what competitive market rates might be. Today, the availability of network elements from self-provisioned or alternative (non-ILEC and intermodal) sources means that market-based or commercially-determined rates will better meet the just and reasonable standard. Where market forces are adequate, any narrowly-defined and tightly-implemented regulatory pricing regime in which prices are set at some measure of cost will not produce rates that meet a just and reasonable standard.

Q. IN COMPETITIVE MARKETS, MUST PRICES BE BASED ON HISTORICAL OR EMBEDDED COST?

A. No. For example, the FCC has accepted the premise that rates *based on* forward-looking cost measures (not necessarily TELRIC but others as well) are superior to historical or embedded costs for setting just and reasonable rates, particularly so in competitive markets.[5] For example, in explaining this perspective in the context of setting just and reasonable prices for ILEC-supplied interstate special access, the FCC stated:

> As an initial matter, forward-looking costs are generally viewed as more relevant to setting prices in a competitive market. Embedded costs associated with past business decisions generally are irrelevant to a rational profit-maximizing firm

[4] TELRIC is the acronym for "total element long run incremental cost."

[5] Note that "based on" does not mean "equal." In markets where firms have a high proportion of fixed costs, competitive market prices are not determined uniquely by costs; both demand and supply (*i.e.*, cost) conditions combine to determine individual service prices in such markets. Thus, when the FCC favors rates *based on* forward-looking costs to those based on embedded costs, that means that the cost concept that affects the competitive market price is a forward-looking cost rather than an embedded cost.

> operating in a competitive market; only forward-looking costs matter to such a firm with regard to business decisions that it is required to make today. Further, ... the [Federal Communications] Commission stated its goal that interstate access charges reflect the forward-looking costs of providing those services.[6]

Below, I document that the FCC has adopted different methodologies to serve as the basis for forming just and reasonable prices. By the same token, it has rejected the use of historical or embedded costs for setting just and reasonable prices. As a general matter, historical or embedded cost-based pricing methodologies have no relevance left in today's telecommunications markets, and have been widely discredited for following arbitrary methods of cost *allocation* rather than of cost *causation*.

Q. PLEASE PROVIDE EXAMPLES OF THE DIVERSITY OF JUST AND REASONABLE PRICING IN TELECOMMUNICATIONS.

A. The FCC adopted incremental (or, following the language of the 1996 Act, "additional") cost of transport and termination for setting just and reasonable reciprocal compensation rates under Section 252(d)(2) of the 1996 Act.[7] In contrast, the FCC relied on a very specific formulaic approach to setting just and reasonable rates for pole attachments.[8] Indeed, under Section 224 of the 1996 Act (which governs the pricing of pole attachments), a *range* of just and reasonable rates can be identified between an incremental cost floor and a ceiling set by a cost allocation formula.

In approving BellSouth's Section 271 application for the states of Georgia and Louisiana, the FCC illustrated how the "just and reasonable" pricing standard may be

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[6] FCC, In the Matter of Special Access Rates for Local Exchange Carriers (WC Docket No. 05-25) and AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services (RM-10593), Order and Notice of Proposed Rulemaking ("*Special Access Order and NPRM*"), released January 31, 2005, ¶65.

[7] FCC, In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996 (CC Docket No. 96-98) and Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers (CC Docket No. 95-185), First Report and Order ("*Local Competition Order*"), released August 8, 1996, ¶1027.

[8] FCC, In the Matter of Implementation of Section 703(e) of the Telecommunications Act of 1996 and Amendment of the Commissions Rules and Policies Governing Pole Attachments, CS Docket No. 97-151, Report and Order ("*Pole Attachments Order*"), released February 6, 1998, Appendix A.

applied differently for UNEs, pole attachments, non-UNEs like 911/E911 and Directory Assistance/Operator Systems, and reciprocal compensation.[9]

In 2000, a grand compromise among ILECs and carriers using interstate access services saw rates for those services reduced to target levels, which the FCC described as being just and reasonable because they were "within the range of economic costs of switched access" with which it had been presented.[10] Again, the emphasis was more on the outcome than on any particular pricing method.

With competition comes less regulatory intervention in what constitutes a just and reasonable price. For example, more recently, the FCC proposed that, in the post-CALLS era, special access rates should be regulated under a price cap regime with built-in pricing flexibility in markets where competitive alternatives are available.[11] In this instance, the FCC relied on market forces to keep special access rates at just and reasonable levels, without the need for re-prescription on the basis of historical costs. This rationale went back to the position on just and reasonable rates that the FCC had evolved as far back as 1999, when it established rules for granting pricing flexibility to ILEC services subject to price cap controls. As the FCC explained:

> To obtain Phase II relief, which allows LECs to raise and lower rates, the incumbent must demonstrate that competitors have established a significant market presence in the provision of the services at issue. Under those market conditions, the availability of alternative providers will ensure that rates are just and reasonable. The triggers we adopt below should permit incumbent LECs to make the required showings, with a minimum of administrative burden for the

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[9] FCC, In the Matter of Joint Application by BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc. for Provision of In-Region InterLATA Services in Georgia and Louisiana, CC Docket No. 02-35, Memorandum Opinion and Order, released May 15, 2002, ¶21, ¶45, ¶47, ¶58, and ¶66.

[10] FCC, In the Matter of Access Charge Reform (CC Docket No. 96-262), Price Cap Performance Review for Local Exchange Carriers (CC Docket No. 94-1), Low-Volume Long Distance Users (CC Docket No. 99-249), and Federal-State Joint Board on Universal Service (CC Docket No. 96-45), Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, and Eleventh Report and Order in CC Docket No. 96-45 ("*CALLS Order*"), released May 31, 2000, ¶176.

[11] *Special Access Order and NPRM*, ¶24, ¶65, and fn. 173.

industry and the Commission.[12]

Q. IN THE SPECIFIC CASE OF A DE-LISTED NETWORK ELEMENT, HOW DOES THE FCC PLAN TO ENSURE THAT THE RATE SET FOR IT BY AN ILEC REMAINS JUST AND REASONABLE?

A. The FCC only requires that the rate for a de-listed network element be set according to the "just and reasonable" standard enunciated by Sections 201 and 202 of the 1934 Act. To ensure compliance with this standard, the FCC has offered the following course of action:

> Whether a particular checklist element's rate satisfies the just and reasonable pricing standard of section 201 and 202 is a fact-specific inquiry that the [Federal Communications] Commission will undertake in the context of a BOC's application for section 271 authority or in an enforcement proceeding brought pursuant to section 271(d)(6). We note, however, that for a given purchasing carrier, a BOC might satisfy this standard by demonstrating that the rate for a section 271 network element is at or below the rate at which the BOC offers comparable functions to similarly situated purchasing carriers under its interstate access tariff, to the extent such analogues exist. Alternatively, a BOC might demonstrate that the rate at which it offers a section 271 network element is reasonable by showing that it has entered into arms-length agreements with other, similarly situated purchasing carriers to provide the element at that rate.[13]

Q. PLEASE EXPLAIN THE SIGNIFICANCE OF THE FCC'S APPROACH TO ENSURING COMPLIANCE WITH THE "JUST AND REASONABLE" STANDARD.

A. The significance of the FCC's approach here is that it would consider the rate of a de-listed network element to be just and reasonable if it is (1) non-discriminatory (in that different rates are not charged for the same network element to different similarly-situated

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[12] FCC, In the Matter of Access Charge Reform (CC Docket No. 96-262), Price Cap Performance Review for Local Exchange Carriers (CC Docket No. 94-1), Interexchange Carrier Purchases of Switched Access Services Offered by Competitive Local Exchange Carriers (CCB/CPD File No. 98-63), and Petition of U S West Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA (CC Docket No, 98-157), Fifth Report and Order and Further Notice of Proposed Rulemaking ("*Pricing Flexibility Order*"), released August 27, 1999, ¶69.

[13] *Triennial Review Order*, ¶664.

purchasing carriers) and *either* (2) the outcome of commercial negotiations with purchasing carriers (where those negotiations are typically conducted in a competitive environment) *or* (3) at or below the rate for services set forth in interstate tariffs. This underscores the FCC's increasing reliance on competitive market forces to generate just and reasonable rates for de-listed network elements.

The procedure that the FCC follows for de-listing a network element (*i.e.*, removing a network element from UNE status under Sections 251 and 252 of the 1996 Act) is commonly referred to as the "impairment test." This analysis is based on Section 252(d)(2) of the 1996 Act which, among other things, directs the FCC to consider whether an ILEC's failure to provide a non-proprietary network element as a UNE would impair a requesting carrier's ability to provide service. Following several iterations of its proposed impairment test (with guidance from the D.C. Circuit Court of Appeals and the U.S. Supreme Court), the FCC has issued the following clarification regarding the conduct of that test.

> We clarify that, in assessing impairment pursuant to the standard set forth in the *Triennial Review Order*, we presume a reasonably efficient competitor. In the *Triennial Review Order*, the Commission concluded that a requesting carrier was impaired "when lack of access to an incumbent LEC network element poses a barrier or barriers to entry, including operational and economic barriers that are likely to make entry into a market uneconomic." The *USTA II* court found that the Commission had failed to answer the question, "Uneconomic by whom?" We therefore take this opportunity to resolve any uncertainty, and hereby clarify that our standard, as written, referred to a reasonably efficient carrier. We consider *all* the revenue opportunities that such a competitor can reasonably expect to gain over the facilities, from providing all possible services that an entrant could reasonably expect to sell, taking into account limitations on entrants' ability to provide multiple services, such as diseconomies of scope in production, management, and advertising.[14]

Following this elaboration of its impairment test, the FCC has decided to de-list the following network elements: (1) mass market local circuit switching; (2) DS-1 capacity dedicated transport connecting wire centers with at least four fiber-based collocators or 38,000 business access lines each; (3) DS-3 capacity dedicated transport connecting wire

[14] See FCC, In the Matter of Unbundled Access to Network Elements (WC Docket No. 04-313) and Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers (CC Docket No. 01-338), Order on Remand ("*Triennial Review Remand Order*"), released February 4, 2005, ¶24. Footnotes in cited text omitted.

centers with at least three fiber-based collocators or 24,000 business access lines each; (4) DS-1 capacity loops serving buildings in wire centers with at least four fiber-based collocators and 60,000 business access lines; (5) DS-3 capacity loops serving buildings in wire centers with at least four fiber-based collocators and 38,000 business access lines; (6) dark fiber loops; and (7) entrance facilities through which collocating competitive local exchange carriers ("CLECs") seek access to the ILEC's network.[15]

Underlying its decision to de-list these network elements is the determination by the FCC that competitive alternatives (including self-supply) exist for CLECs and that not provisioning those network elements as UNEs at TELRIC-based prices does not impair the CLECs. Thus, in these circumstances, while rates for de-listed network elements must remain just and reasonable as long those network elements remain subject to the provisions of Section 271 of the 1996 Act, it follows that an ILEC has much greater flexibility in how it sets rates for de-listed network elements than it does for UNEs that remain subject to Sections 251 and 252 of the 1996 Act.

Q. WHAT DOES THE GREATER FLEXIBILITY FOR ILECS ENTAIL FOR SETTING JUST AND REASONABLE RATES FOR DE-LISTED NETWORK ELEMENTS?

A. The greater flexibility entails that an ILEC like BellSouth can increasingly pursue commercial negotiations or tariffed options for de-listed network elements with requesting or purchasing carriers against the backdrop of a *competitive* market. The fact that such negotiations can occur in competitive circumstances is important because the FCC's policy is to relieve a network element of its UNE status only in those circumstances. A finding of non-impairment (needed for de-listing) is necessarily predicated on a prior finding of adequate competition (and the availability of feasible competitive alternatives, including self-supply) for the network element in question. Therefore, once a network element is de-listed, it need no longer be priced according to some prescribed formula. Rather, the

[15] *Id.*, ¶5.